



The Commonwealth of Massachusetts

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 06-2

February 14, 2006

Petition of Southern Union Company for authorization and approval pursuant to G.L. c. 164, § 17A, to loan the proceeds of up to \$1.7 billion in short-term bridge financing to Southern Union Gathering Company, LLC and pledge an equity interest to fund the acquisition of Sid Richardson Energy Services, Ltd. and Richardson Energy Marketing, Ltd.

APPEARANCES:

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FOR: SOUTHERN UNION COMPANY
Petitioner

I. INTRODUCTION

On January 9, 2006, Southern Union Company (“Southern Union” or “Company”) filed a petition with the Department of Telecommunications and Energy (“Department”) for authorization and approval pursuant to G.L. c. 164, § 17A, to loan to its wholly-owned subsidiary, Southern Union Gathering Company, LLC (“SUGC”), the proceeds of up to \$1.7 billion in short-term bridge financing to be used for the purpose of enabling SUGC to acquire Sid Richardson Energy Services, Ltd. and Richardson Energy Marketing, Ltd. (together “SRES”).¹ Southern Union also seeks authorization and approval, pursuant to G.L. c. 164, § 17A, to pledge its equity ownership in Panhandle Eastern Pipeline Company (“Panhandle Eastern”) to secure the short-term bridge financing. No person filed for intervenor or limited participant status. The Department docketed the filing as D.T.E. 06-2.

Pursuant to notice duly issued, the Department conducted public and evidentiary hearings at the Department’s offices on January 27, 2006. In support of its petition, the Company offered the testimony of Richard N. Marshall, vice president and treasurer of Southern Union. The evidentiary record includes 23 exhibits. On February 2, 2006, the Company submitted comments in support of its petition.

¹ SRES is a privately held natural gas gathering and processing company employing approximately 250 employees and headquartered in Fort Worth, Texas. SRES’s gathering and processing operations include: (1) field gathering and compression, (2) treatment, dehydration, sulfur recovery and other natural gas product conditioning, (3) natural gas processing, and (4) the sale of natural gas liquids and pipeline quality residue gas (Exh. SU-1, at 4).

II. DESCRIPTION OF THE COMPANY'S PROPOSALS

SUGC has entered into a purchase and sale agreement to acquire 100 percent of a limited partner interest in SRES (Exh. SU-2, at 1, 11). In addition, Southern Union Panhandle, LLC² will acquire 100 percent of the general partner interest in SRES (id.). The total purchase price will be approximately \$1.6 billion, allowing for several adjustments to be determined upon closing (id. at 11-12).³ Although Southern Union assumes that its net financing needs are \$1.6 billion, the Company seeks approval to loan “up to” \$1.7 billion to SUGC, because the final price is subject to post-closing adjustments, for items such as net working capital and out-of-pocket expenses (see, e.g., Exh. SU-2, § 2.5, at 12).

Southern Union Panhandle, LLC and SUGC will close the acquisition transaction using interim “bridge” financing at the Southern Union level (Exhs. SU-1, at 6; DTE-1-2). The bridge financing will mature 364 days or less from the date on which it is issued (Exh. DTE-1-15). As collateral for the interim bridge financing, Southern Union will pledge its ownership interests in SRES and Panhandle Eastern to the bridge loan lending parties (Exh. SU-1, at 6). Upon the acquisition of SRES, the Company anticipates that there will be no debt outstanding at the SUGC level (Exhs. SU-1, at 6; DTE-1-2). Any debt incurred

² Southern Union Panhandle, LLC is a subsidiary of Southern Union. Panhandle Eastern in turn is owned and operated by Southern Union Panhandle, LLC. Southern Union Company, D.T.E. 03-3, at 1-4 (2003).

³ The purchase and sale agreement provides that the purchase price “shall consist of \$1,600,000,000 (\$1,580,386,500 in respect of the Limited Partner Interests and \$19,613,500 in respect of the General Partner Interests) minus the Net Working Capital Change Amount (which shall be divided as between the buyers in the same proportion)” (Exh. SU-2, at 11).

thereafter by SUGC for the purpose of repaying the bridge loan will be non-recourse to Southern Union and its utility operations (Exh. SU-1, at 6). In addition to the issuance of non-recourse debt at the SUGC level to repay the bridge loan, the financing may involve the issuance of debt and equity securities by Southern Union for the purpose of repaying the bridge loan and funding its investment in SUGC (Exh. SU-1, at 7). The details of the permanent financing arrangements are not yet known.⁴ Southern Union represents that it will submit a separate filing to the Department for approval of issuance of any such debt or other securities (id.).

Following the acquisition, the SRES operations will be integrated with those of Southern Union, including Panhandle Eastern, which is headquartered in Houston, Texas (id. at 4). As a result of the acquisition of SRES by SUGC and Southern Union Panhandle, LLC, Southern Union will operate an interstate gas distribution system through its subsidiaries comprising approximately 22,000 miles of pipeline spanning from the Gulf of Mexico to the Southwest, Midwest, and Canada and serving customers in eighteen states (Exhs. SU-1, at 5; SU-3).⁵

⁴ The Company recently agreed to sell its local distribution company (“LDC”) operations in Pennsylvania for \$580 million, and states that it likely will sell one of its remaining LDCs before proceeding to the capital markets to finance the remainder of the bridge loan (Tr. at 5–6).

⁵ None of the Panhandle Eastern or SRES pipeline assets to be pledged as security for the bridge loan are directly used to serve customers in Massachusetts (Exh. DTE-1-12(c) at 4, 7).

III. STANDARD OF REVIEW

Pursuant to G.L. c. 164, § 17A, a gas or electric company must obtain written Department approval in order to “loan its funds to, guarantee or endorse the indebtedness of, or invest its funds in the stock, bonds, certificates of participation or other securities of, any corporation, association or trust” The Department has indicated that such proposals must be “consistent with the public interest,” that is, a § 17A proposal will be approved if the public interest is at least as well served by approval of the proposal as by its denial.

Massachusetts Electric Company, D.T.E. 01-104, at 4 (2002); citing Bay State Gas Company, D.P.U. 91-165, at 7 (1992); see Boston Edison Company, D.P.U. 850 (1983).

The Department has stated that it will interpret the facts of each § 17A case on its own merits to make a determination that the proposal is consistent with the public interest.

D.P.U. 91-165, at 7. The Department will base its determination on the totality of what can be achieved rather than a determination of any single gain that could be derived from the proposed transactions. Id.; see D.P.U. 850, at 7. The Department also found that the public interest standard best accommodates the Department’s interest in protecting the utility’s ratepayers from the adverse effects of unwarranted § 17A transactions and a utility’s interest in having flexibility in a changing marketplace to meet long-term objectives of its ratepayers and shareholders. D.P.U. 91-165, at 7; Boston Edison Company, D.P.U. 97-17, at 6 (1997).

Thus, the Department’s analysis must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the proposal. D.P.U. 91-165, at 8. The effect on ratepayers may include consideration of a number of factors, including, but not

limited to: the nature and complexity of the proposal, the relationship of the parties involved in the underlying transaction, the use of funds associated with the proposal, the risks and uncertainties associated with the proposal, the extent of regulatory oversight over the parties involved in the underlying transaction, and the existence of safeguards to ensure the financial stability of the utility. Id.

IV. ANALYSIS AND FINDINGS

Southern Union requests approval from the Department to loan the proceeds of up to \$1.7 billion in short-term bridge financing to SUGC for the purpose of acquiring SRES (Exh. SU-1, at 3). The Company also seeks approval to pledge its equity ownership interest in Panhandle Eastern as security for the interim bridge loan financing (id.). These approvals are required pursuant to G.L. c. 164, § 17A.⁶

Concerning the nature and complexity of the Company's proposal, the Department recognizes that Southern Union has experience in complex financial transactions involving multiple corporations, as evidenced by its acquisition of Panhandle Eastern in 2003, its equity arrangement with CCE Holdings, LLC in 2004, as well as various LDCs located across the country (Exh. DTE-1-8). See Southern Union Company, D.T.E. 04-75 (2004); Southern

⁶ In addition to the Department's oversight, Southern Union's proposed acquisition of SRES is subject to antitrust approval by the Federal Trade Commission (Exhs. SU-1, at 5; DTE-1-19).

Union Company, D.T.E. 03-3 (2003).⁷ None of these transactions had negative consequences on the Company's local distribution operations (Exhs. SU-1, at 7; DTE-1-8).

The Department's review of the proposed investment must consider the overall anticipated effect on ratepayers of the potential harms and benefits of the transactions. In evaluating the potential benefits to ratepayers associated with the proposed transaction, the Department determines that the \$1.7 billion loan to SUGC will facilitate the acquisition of SRES. Acquisition of the SRES operations will enhance the Company's overall financial operations through additional free cash flow yield (defined as net income plus depreciation less maintenance capital requirements) in excess of 20 percent annually (Exh. DTE-1-10). This additional cash flow can be used to reduce debt and improve the Company's ability to access the capital markets, thereby benefitting ratepayers (Exh. SU-1, at 8; Tr. at 15). Moreover, the acquisition of SRES will provide Southern Union an opportunity to achieve financial and operating synergies that will help to control or reduce costs for the overall system, thereby also benefitting ratepayers (Exh. SU-1, at 6, 8-9).

In evaluating the potential harms to ratepayers associated with the proposed transaction, the Company acknowledges that its investment in SRES has a higher risk profile than investments in local distribution or interstate pipeline companies, because (1) Southern Union has no experience in the gas gathering and processing business, or "midstream" operations;

⁷ CCE Holdings, LLC, a joint venture between Southern Union and GE Commercial Finance Energy Financial Services, acquired a 100 percent equity interest in CrossCountry Energy, LLC, which is a holding company that owns interests in and operates several pipeline systems. D.T.E. 04-75, at 1.

and (2) the value of its investment in SRES is more dependent upon commodity prices than are the values associated with its interstate and local distribution companies (Tr. at 6–7).

Concerning the first risk factor associated with the nature of the SRES operations, Southern Union intends to manage SRES as a subsidiary and retain key SRES personnel, as it had done with its acquisitions of Panhandle Eastern and CrossCountry Energy, LLC (Exh. SU-1, at 7, 10–11). There is no evidence that these recent acquisitions had any negative effect on ratepayers through the diversion of management resources or attention away from the local distribution operations to these other ventures (id. at 7). Concerning the second risk factor associated with the valuation of SRES, as noted above, SRES is a well-established provider of “midstream” gas service (id. at 4). SRES also has established a record of safe and reliable operations (id. at 7). Therefore, the Department is satisfied that the non-regulated nature of SRES’s operations pose minimal investment risk to Southern Union.

Concerning the pledge of SRES and Panhandle Eastern assets as security for the interim bridge loan, the Company has demonstrated that by including Panhandle Eastern’s assets in its security pledge for SRES, Southern Union will receive more favorable terms on its interim bridge loan through both a lower interest rate spread and lower fees (Exh. DTE-1-1). The Company estimates that, assuming the use of a six-month interim bridge loan, it would realize a potential savings in interest expense of \$12 million over the cost with a security pledge only for SRES assets (Exh. DTE-1-1). The Department has reviewed the Company’s financial and operating data from its most recent Form 10-K and Form 10-Q, along with information submitted to the United States Securities and Exchange Commission concerning these

transactions, and is satisfied that there is minimal risk that the Company would default on its interim bridge loan (Exhs. DTE-1-12; DTE-1-13). Even in the unlikely event that Southern Union were to default, the Panhandle Eastern and SRES assets are not related to the Company's local distribution operations in Massachusetts. Therefore, the pledge of those assets would have no direct consequence to ratepayers.

In this case, the record shows that, after balancing all of the factors involved in the Company's proposals, the investment results in no net harm to ratepayers, and customers will be at least as well served by the Department's approval of the proposed transactions as by their denial. Therefore, the Department finds that the Company's proposals to loan up to \$1.7 billion to SUGC in the form of proceeds of an interim bridge loan for the purpose of acquiring SRES, as well as the pledge of Southern Union's equity ownership in Panhandle Eastern as security for the interim bridge loan, are consistent with the public interest as required by G.L. c. 164, § 17A. Accordingly, the Department approves the Company's proposals. The Department's determination in this Order is not in any way to be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any assets acquired or any costs associated with the proposed transactions.

V. ORDER

Accordingly, after due notice, hearing, and consideration, the Department:

VOTES: That approval and authorization pursuant to G.L. c. 164, § 17A for Southern Union Company to loan the proceeds of a short-term bridge loan in an amount not to exceed \$1,700,000,000 to Southern Union Gathering Company, LLC to fund the acquisition of Sid Richardson Energy Services, Ltd. and Richardson Energy Marketing, Ltd., is consistent with the public interest as required by G.L. c. 164, § 17A; and

VOTES: That approval and authorization pursuant to G.L. c. 164, § 17A for Southern Union Company to pledge its equity ownership in Panhandle Eastern Pipeline Company, is consistent with the public interest as required by G.L. c. 164, § 17A; and therefore, it is

ORDERED: That the Department approves and authorizes Southern Union Company to loan the proceeds of a short-term bridge loan in an amount not to exceed \$1,700,000,000 to Southern Union Gathering Company, LLC to fund the acquisition of Sid Richardson Energy Services, Ltd. and Richardson Energy Marketing, Ltd., in conformity with all provisions of law relating thereto; and it is

FURTHER ORDERED: That the Department approves and authorizes Southern Union Company to pledge its equity ownership in Panhandle Eastern Pipeline Company to secure the short-term bridge loan, in conformity with all provisions of law relating thereto.

By Order of the Department,

/s/
Judith F. Judson, Chairman

/s/
James Connelly, Commissioner

/s/
W. Robert Keating, Commissioner

/s/
Paul G. Afonso, Commissioner

/s/
Brian Paul Golden, Commissioner

An appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.